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October 18, 2019

VIA ELECTRONIC FILING

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c/o Document Control Center
State Corporation Commission
1300 E. Main Street
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Re: *Application of Virginia Electric and Power Company, For the determination of the fair rate of return on common equity pursuant to § 56-585.1:1 C of the Code of Virginia*
Case No. PUR-2019-00050

Dear Mr. Peck:

Enclosed for filing in the above-captioned matter is the Post-Hearing Brief of the Virginia Poverty Law Center.

Should you have any questions about this filing, please do not hesitate to contact me.

Sincerely,

/s/ William T. Reisinger

William T. Reisinger

cc: Service List

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUR-2019-00050

For the determination of the fair rate of return on
Common equity pursuant to § 56-585.1:1 C
of the Code of Virginia

**POST-HEARING BRIEF OF THE
VIRGINIA POVERTY LAW CENTER**

Pursuant to the directive of the State Corporation Commission (“Commission”) at the conclusion of the September 11, 2019, evidentiary hearing in this matter, the Virginia Poverty Law Center (“VPLC”), by counsel, hereby submits its Post-Hearing Brief.

INTRODUCTION

Virginia Electric and Power Company, doing business as Dominion Energy Virginia (“Dominion” or “Company”), filed its Application on March 29, 2019, pursuant to Va. Code § 56-585.1:1 C. Dominion requests Commission approval of a rate of return on common equity (“ROE”) of 10.75%. This represents a 17% increase from the Company’s currently authorized return of 9.2%. The requested 10.75% ROE, if approved by the Commission, would be applied to Dominion’s numerous – and increasing – rate adjustment clauses (“RACs”) authorized under Code § 56-585.1 A 5 and A 6. Some of these RACs already include a 100 basis points ROE bonus.¹ Dominion’s request would result in a \$147 million increase in Dominion’s total revenue requirement.²

¹ Tr. 198.

² Ex. 12 (Myers) at 3.

The ROE established in this case will also be used to measure Dominion's earnings in its next base rate earnings review, which is scheduled to commence in 2021 pursuant to Va. Code § 56-585.1:1 A. The results of the 2021 earnings review may affect the base rates paid by Dominion's customers going forward and could determine whether, and to what extent, customers receive rate credits, or refunds, for Dominion's past overcharges. By law, any such refunds must be credited to customers' bills over a period of 6 to 12 months. Accordingly, the ROE set in this case could have a substantial impact on Dominion's RAC rates, its future base rates, and the refunds that low-income customers could receive for the Company's past overearnings.

ARGUMENT

Dominion's requested ROE of 10.75% is clearly excessive and would result in unnecessary rate and bill increases for the low-income customers Dominion represents. During Dominion's last ROE proceeding, in 2017, the Commission found that 9.0% represented Dominion's then-current cost of equity. The evidence presented in this case, however, demonstrates that national interest rates remain at historically low levels, while utilities, and Dominion in particular, are seen as increasingly safe investments. The evidence, including the analysis of the Commission Staff and the Attorney General, shows that Dominion's cost of equity is now below 9.0%.

For the reasons explained herein, VPLC urges the Commission to reduce Dominion's ROE and set a return as close as possible to the Company's cost of equity. Such a result would be fair to investors and ratepayers; would provide some measure of rate and bill relief for low-income customers; and would strengthen consumer confidence in Virginia's regulatory climate.

A. The resolution of this case will affect customer rates and bills.

As a preliminary matter, there should be no uncertainty after this case that Dominion's ROE affects the rates and bills that customers pay. It is not disputed that the ROE established in this case will be used to set the rates for Dominion's rate adjustment clauses ("RACs" or "riders"). Dominion already has numerous RACs, and most of the Company's forecasted capital expenditures can be recovered through RACs instead of through base rates.³ The rate impact of the new ROE for each individual RAC would be more or less immediate. As Ms. Myers explained, the revenue requirements for the RACs "would be based on whatever ROE the Commission approves in this proceeding" and would be effective upon the Commission's final order.⁴

With regard to base rates and customer bills, Dominion's assertions throughout this proceeding were misleading. Dominion, for example, represented that "we're not setting rates in this proceeding,"⁵ that "any increase in the Company's ROE arising from this proceeding will have *no impact* on customers monthly bills for base rates,"⁶ that and Company's ROE "will not affect customer bills in 2021."⁷

As Staff witness Meyers testified, however, these representations are "fundamentally untrue."⁸ Ms. Myers explained how the ROE set in this case will affect both customer base rates and customer bills:

So there's two things. There are customer rates, and then there are customer bills. I realize that the Company is precluded from seeking an increase to base rates in the first triennial review, but that does not mean that there will be no impact on customer bills. As I explained in my surrebuttal and also in my testimony, the ROE

³ 71% of Dominion's capital expenditures proposed for the next five years could be recovered through riders. See Ex. 12 (Myers) at 4, 15; see also Tr. 197.

⁴ Tr. 164-165.

⁵ Tr. 25.

⁶ Ex. 5 (Ingram) at 5 (emphasis original); Tr. 316 (emphasis original).

⁷ Tr. 167.

⁸ Tr. 50, 153.

that the Commission determines in this proceeding will have an impact on customer bills as a result of the triennial review process.

...

It could impact the amount of a refund or the customer credit reinvestment offset, which both have an impact on customer bills.⁹

VPLC agrees with Ms. Myers' assessment. The Company's ROE established in this case will be used to measure the Company's earnings in the 2021 earnings review. A higher ROE, therefore, could reduce the amount of overearnings and thereby reduce or eliminate any customer refunds.¹⁰ Moreover, the ROE set in this case could affect whether consumers are entitled to a limited rate reduction of up to \$50 million following the 2021 earnings review.¹¹

Any refunds, of course, are paid via customers' monthly bills. Pursuant to Va. Code § 56-585.1 A 8 b, any refunds resulting from the 2021 review "shall be credited to customers' bills ... over a period of six to 12 months." In Dominion's 2015 biennial review proceeding, for example, the Commission found that customers were owed refunds, which the Commission directed Dominion to credit to customers' bills over a six-month period.¹² When customers receive refunds or credits for a six or 12 month period, their monthly bills are *lower* than they otherwise would be during that time period.

Indeed, in light of Virginia's ratemaking laws – which make it exceedingly difficult for the Commission to reduce the rates of this particular monopoly – refunds for past overcharges are especially important. Refunds of a portion of overearnings are one of the few chances customers have for rate relief under the current regulatory structure.

⁹ Tr. 168.

¹⁰ See Tr. 168.

¹¹ See Tr. 156.

¹² Case No. PUE-2015-00027, Final Order at 16 (November 23, 2015).

B. The Commission should set Dominion's rate of return as close as possible to the Company's cost of equity, which the evidence demonstrates is well below 9.0%.

While VPLC did not provide a cost of equity analysis or recommendation in this case,¹³ VPLC supports the cost of equity analyses presented by Staff witness Pippert and Attorney General witness Woolridge. Dr. Woolridge supports a cost of equity range of 7.6% to 8.8%,¹⁴ while Ms. Pippert supports a range of 8.1% to 9.1% and recommends a midpoint of 8.6%.¹⁵ These witnesses present credible evidence that interest rates are at historically low levels;¹⁶ that the Federal Reserve is likely to continue its accommodative monetary policy;¹⁷ that utilities in general, and Dominion in particular, are subject to limited business risk;¹⁸ that national ROEs are gradually trending downward as capital costs decline;¹⁹ and that other factors indicate that Dominion's cost of equity is now below the 9.0% level that the Commission found to be reasonable in Dominion's 2017 ROE proceeding.²⁰

1. Mr. Hevert's recommendations should be given little weight.

As a preliminary matter, VPLC believes the ROE recommendations presented by Dominion witness Hevert should be given little, if any, weight. The Commission Staff and the respondent ROE witnesses raised valid concerns about several of Mr. Hevert's methodologies

¹³ Mr. Rábago did not conduct an independent cost of equity analysis or provide a recommendation regarding the appropriate cost of equity range for Dominion. Mr. Rábago's testimony, however, "does address the factors cited by the Company witness, Mr. Hevert, as justification for a ROE higher than the lowest value in the range of reasonable ROE values, specifically relating to the Company's capital spending plans, the regulatory environment in Virginia, and evolving market and business conditions." Moreover, Mr. Rábago "did not validate or verify Company witness Hevert's identification of the initial pool of utilities eligible for inclusion in the benchmarking, or specifically with his application of the criteria in Va. Code § 56-585.1 A 2 b i through iv." Ex. 9 (Rábago) at 20.

¹⁴ Tr. 46.

¹⁵ Ex. 15 (Pippert) at 2.

¹⁶ See, e.g., Ex. 10 (Woolridge) at 4.

¹⁷ Ex. 15 (Pippert) at 15.

¹⁸ See, e.g., Ex. 15 (Pippert) at 4.

¹⁹ See, e.g., Ex. 10 (Woolridge) at 14; Tr. 122-123.

²⁰ At the hearing, Dominion witness Hevert conceded that the returns recommended by Dr. Woolridge and the Commission Staff were very close to the Commission's findings in Dominion's 2017 ROE proceeding. Tr. 85.

and model inputs. In particular, Mr. Hevert continues to use certain methodologies that the Commission has consistently rejected, such as using unreasonably high projected interest rates in his calculations and employing overly optimistic growth rates in his discounted cash flow model. In Dominion's 2017 ROE proceeding, the Commission found that these methodologies "upwardly skew [the] results" of Mr. Hevert's recommendations.²¹ In particular, with regard to interest rates, Dr. Woolridge correctly noted that "[e]conomists have been predicting that interest rates would be going up for a decade, and they consistently have been wrong."²² At the hearing, Mr. Hevert acknowledged that other state public utilities commissions have typically found his recommendations to be too high.²³

2. The statutory peer group floor should be calculated in a manner that allows the Commission to set Dominion's return as close as possible to its cost of equity.

VPLC understands that the Commission is subject to some statutory limitations when setting Dominion's ROE in this case. Pursuant to Va. Code § 56-585.1 A 2, the Commission may not set Dominion's return below the average earned returns of a group of "peer" utilities. Nonetheless, VPLC urges the Commission to calculate the peer group floor in a manner that permits a return that is as close as possible to Dominion's cost of equity. This result would be fair to both Dominion and to customers.

There appear to be three major disagreements among Dominion, Staff, and the other case participants concerning the peer group calculation. The first is whether two particular utilities (Mississippi Power and South Carolina Electric & Gas Company) should be included in the peer group for purposes of calculating Dominion's ROE floor. The second disagreement concerns

²¹ Case No. PUR-2017-00038, Final Order at 4-5.

²² Ex. 10 (Woolridge) at 12.

²³ Ex. 4; Tr. 78.

whether it is appropriate to measure the earned returns of the peer utilities on a year-end or average equity basis.

When conducting the statutory peer group calculation, the Commission is conducting a “ratemaking procedure.” The Virginia Supreme Court has held that “when the Commission is conducting a ratemaking procedure, it is exercising a legislative function delegated to it by the General Assembly.” In such cases, the Court will “presume that any limitation on the Commission’s discretionary authority by the General Assembly will be clearly expressed in the language of the statute.”²⁴

Virginia Code Section 56-585.1 A 2 b contains four specific criteria for the types of utilities that *must* be included in the peer group. The statute does not, however, require the Commission to use “average” or “year-end” equity when calculating the earnings of peer utilities; this decision is therefore clearly within the Commission’s discretion. Nor does the Code require a utility to be excluded because of low earnings levels; the statute includes several specific criteria, including a bond rating requirement, but does not speak to earnings levels. The Code does not state that utilities that become affiliates of the subject company must be excluded if the merger occurs *after* the statutory test period. While there is no stated temporal requirement for the affiliate criterion, the Code does state that the minimum bond rating is measured “at the end of the most recent test period.” For all of these reasons, VPLC believes the Commission has maximum discretion to address the three disputed issues concerning the peer group calculation.

²⁴ *Virginia Elec. and Power Co. v. State Corporation Comm’n*, 284 Va. 726, 741, 735 S.E.2d 684, 691 (2012).

Finally, as counsel for Walmart argued at the hearing, a plain reading of the statute indicates that the Commission has discretion to include utilities in the peer group calculation even if such utilities do not meet the four criteria described in the statute.²⁵

These factors all indicate that the Commission has the flexibility to calculate a reasonable peer group floor – i.e., one that will allow the Commission to set a return that is consistent with the utility’s cost of equity and that is fair to both Dominion and its customers. Indeed, as the Virginia Supreme Court would likely agree, the fundamental purpose of this proceeding is to set a fair and reasonable rate of return – not to set an unfair or unreasonable one. For the foregoing reasons, VPLC believes the Commissions has the discretion to calculate a reasonable peer group floor, allowing the Commission to set Dominion’s ROE close to the utility’s cost of equity.

3. Dominion’s actual earnings are likely to be well above the return authorized in this case – whether that return is 8.0% or 11.0%.

It is important to note that the rate of return the Commission *authorizes* in this case is not the rate of return that Dominion will actually *earn*. While rider revenues are predictable (and guarantee full cost recovery, including the utility’s authorized rate of return), base rate earnings are variable. Dominion’s actual base rate ROE will almost certainly be much higher than the return authorized in this case. This result is due to Virginia’s unique ratemaking statutes and, as VPLC discussed at the hearing, is confirmed by recent history.²⁶ Earlier this year, for example, the Commission found that Dominion’s base rates produced an actual earned return of 13.47% during 2018, representing overearnings of \$277 million.²⁷ During 2017, the Commission found

²⁵ Tr. 37 (“[T]here are a subset of utilities that [the Commission is] required by law to include in the statutory peer group analysis. It is any utility that meets the four criteria set forth in that statutory provision; however, there is nothing in that provision that prohibits this Commission from exercising its discretion as to whether or not to include a company like [South Carolina Electric & Gas].”)

²⁶ Tr. 43.

²⁷ Tr. 43; State Corporation Commission Status Report: Implementation of the Virginia Electric Utility Regulation Act Pursuant to § 56-596 B of the Code of Virginia at 9 (August 29, 2019).

Dominion's actual earned base rate ROE to be 13.84%.²⁸ The Commission's finding for 2016 was 12.87%.²⁹ These findings were based on unaudited financial data provided by Dominion outside of a litigated earnings review case.

And while Dominion's current base rates are consistently producing earned ROEs above Dominion's authorized return, Dominion is recovering more and more of its costs of service through riders. Staff witness Myers testified that 71% of Dominion's capital expenditures proposed for the next five years could be recovered through riders.³⁰ Riders guarantee full cost recovery, including the Company's authorized rate of return. Moreover, some of the largest generating assets in Dominion's rate base – representing the largest line items on customers' bills – are not only recovered through riders; they also receive a bonus rate of return of 100 basis points (1.0%).³¹ This means that whatever ROE the Commission awards in this case will be increased by *an additional* 100 basis points for these facilities. The Code also allows Dominion to receive bonus ROEs for any new offshore wind or nuclear facilities that are recovered through rate adjustment clauses.³²

4. The Commission should not consider potential rankings from the Regulatory Research Associates when determining Dominion's cost of equity.

At the hearing and in pre-filed testimony, there was significant discussion regarding a ratings agency called Regulatory Research Associates ("RRA"). Dominion witness Hevert argued that states that are viewed as "supportive" or "constructive" earn more favorable ratings

²⁸ State Corporation Commission Status Report: Implementation of the Virginia Electric Utility Regulation Act Pursuant to § 56-596 B of the Code of Virginia at 6 (August 28, 2018)

²⁹ State Corporation Commission Status Report: Implementation of the Virginia Electric Utility Regulation Act Pursuant to § 56-596 B of the Code of Virginia at 6 (September 1, 2017).

³⁰ See Ex. 12 (Myers) at 4, 15; see also Tr. 197.

³¹ See Tr. 198; see also Ex. 18 (showing bonus ROEs applied to the Virginia City, Bear Garden, Brunswick County, and Warren County generating facilities.)

³² Va. Code § 56-585.1 A 6.

from RRA.³³ The RRA “constructiveness” rankings consider things such as the regulatory framework and the state commission’s recent rate case decisions. Dominion’s implication was that Virginia could lose its position at the top of the RRA rankings if the Commission were to adopt the Staff’s or the Attorney General’s cost of equity recommendations.

RRA measures “regulatory constructiveness” from an investor – not a consumer – perspective.³⁴ Mr. Hevert explains that “less constructive environments are associated with higher levels of risk” – for investors.³⁵ At the hearing, Dominion’s clear implication was that, under RRA’s methodology, a state will be ranked higher if its utilities commission authorizes higher utility ROEs. RRA already ranks Virginia near the top of its regulatory constructiveness rankings – in the top 8 out of 54 U.S. jurisdictions.³⁶ Virginia has maintained this exceptional ranking despite the fact that the Commission has reduced Dominion’s authorized return several times since 2011, corresponding to declining costs of capital and lower national returns.³⁷ The Commonwealth maintained its top RRA ranking even after the Commission endorsed a cost of equity of 9.0% in both Dominion’s 2017 ROE proceeding³⁸ and in Appalachian Power Company’s (“APCo”) 2018 ROE proceeding.³⁹ This suggests that Virginia will retain its “constructive” ranking from RRA even if the Commission accepts the cost of equity recommendations of its Staff or the Attorney General.

More fundamentally, it is not clear why this particular metric matters. Dominion offers few, if any, reasons why the Commission should care about the RRA rankings. How, in theory,

³³ Ex. 3 (Hevert) at 35-37.

³⁴ See Tr. 228.

³⁵ Ex. 3 (Hevert) at 36.

³⁶ Tr. 236.

³⁷ Dominion’s counsel noted that the Company’s authorized return has declined by 120 basis points over the last 8 years. Tr. 16-17.

³⁸ Tr. 52-53.

³⁹ Case No. PUR-2018-00048, Final Order at 4 (November 7, 2018).

might a marginally higher RRA ranking support Dominion's financial strength, enhance its ability to attract capital, or help the utility fulfill its public service obligations? The Company does not say. Dominion did not assert that it has had any problems obtaining capital on favorable terms due to the fact that the Commission in recent years has authorized ROEs below the Company's requests returns.⁴⁰ There is no evidence in the record that an *even higher* RRA ranking for Virginia would result lower borrowing costs for Dominion, lower rates for consumers, or other economic benefits for any citizens of the Commonwealth who are not Dominion investors.

Mr. Rábago, himself a former state commissioner, says that state commissions "should not play the [RRA] game at all."⁴¹ "Chasing ratings by driving up ROE and electricity costs," Mr. Rábago argues, "is not regulation in the public interest."⁴² VPLC urges the Commission to reject all recommendations based on RRA rankings.

5. Any decision other than a reduction to Dominion's going forward ROE could be viewed by consumers "as a signal of a deteriorating regulatory climate in Virginia."

At the hearing, Dominion called the recommendations of Ms. Pippert and Dr. Woolridge "dangerous recommendations," suggesting that the judgment of these professionals could be viewed by investors "as a signal of a deteriorating regulatory climate in Virginia."⁴³ As VPLC explained at the hearing, the Commission should strive to "balance the interests of customers and investors," and in doing so should "consider the fact that this balance in recent years has tilted towards investors."⁴⁴

⁴⁰ Tr. 91.

⁴¹ Ex. 9 (Rábago) at 17.

⁴² Id.

⁴³ Tr. 24.

⁴⁴ Tr. 42.

This balance is relevant because in recent rate cases, earnings tests, and annual reports to the General Assembly, the Commission has consistently found (1) that Dominion is earning well in excess of its authorized return, reflecting excess profits of hundreds of millions of dollars each year, and (2) that Dominion's rates, which have increased by 26% since 2007, will likely go up even more.⁴⁵ Dominion's ratepayers are aware of this too. The Commission received hundreds of unique public comments in this proceeding, many from customers who cited both rate increases and Dominion's overearnings as reasons not to grant Dominion's ROE increase request.

While Dominion suggests that the Commission should be influenced by *investors'* view of "regulatory constructiveness," VPLC submits that the Commission should instead consider the effect its decision could have on the confidence of Virginia *consumers*. It would be a difficult task for VPLC to explain to an ordinary consumer or small business owner why a monopoly that consistently earns annual excess profits of hundreds of millions of dollars is entitled to an *even higher* profit level. Indeed, such a scenario could be viewed by consumers "as a signal of a deteriorating regulatory climate in Virginia."

CONCLUSION

For the foregoing reasons, VPLC urges the Commission to use its legislative discretion to set Dominion's ROE as close as possible to the utility's cost of equity. For these purposes, VPLC supports the cost of equity recommendations provided by witnesses for the Commission Staff and the Attorney General. Based on the evidence in this case, a return that is below 9.0%, but within the ranges supported by these witnesses, would be fair to both the utility and its ratepayers and would satisfy all statutory and constitutional requirements.

⁴⁵ Tr. 43.

Respectfully submitted,

VIRGINIA POVERTY LAW CENTER

By counsel

/s/ William T. Reisinger

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October 18, 2019

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing was served this 18th day of October, 2019, by first class mail and/or e-mail to:

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Appendix A

VPLC Issues Matrix

Relevant issues include:

- (1) Whether the cost of equity capital for Dominion has increased, decreased, or stayed the same since 2017;
- (2) The appropriate rate of return on common equity ("ROE") for Dominion – i.e., the percentage return the Commission finds is appropriate notwithstanding the statutory benchmarking methodology described in Va. Code § 56-585.1 A 2;
- (3) The appropriate group of "peer utilities" to be used to set an ROE floor pursuant to Va. Code § 56-585.1 A 2;
- (4) Whether the Commission should calculate the returns of peer utilities using "year-end" or "average" common equity;
- (5) Whether, and to what extent, Dominion's ROE will affect customer rates, bills, and potential refunds;
- (6) Whether investor rankings agencies such as the Regulatory Research Associates should be a factor in the Commission's determination of a utility's cost of equity or its ROE.